91st Congress 2d Session } HOUSE OF REPRESENTATIVES { Report No. 91-1779

COMPUTATION OF POLICYHOLDERS' SHARE OF INVESTMENT YIELD ON LIFE INSURANCE COMPANY TAX RETURNS

December 17, 1970.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. Mills, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 19881]

The Committee on Ways and Means, to whom was referred the bill (H.R. 19881) consolidated returns of life insurance companies, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the following:

That (a) section 818 of the Internal Revenue Code of 1954 (relating to life insurance company accounting provisions) is amended by adding at the end thereof the following new subsection:

"(g) Computation on Consolidated Returns of Policyholders' Share of Investment Yield.—For purposes of this part, in the case of a life insurance company filing or required to file a consolidated return under section 1501 for a taxable year, the computations of the policyholders' share of investment yield under subparts B and C (including all determinations and computations incident thereto) shall be made as if such company were not filing a consolidated return."

(b) The amendment made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1957.

Sec. 2. (a) If—

(1) any insurance company subject to taxation under section 802 of the Internal Revenue Code of 1954 filed a consolidated return under section 1501 of such Code for any taxable year beginning after December 31, 1957, and ending before March 13, 1969, and

(2) not later than one year after the date of the enactment of this Act—

(A) such company elects (in such manner as the Secretary of the Treasury or his delegate may prescribe) to have this section apply,

(B) such company files consents to the application of this section of all companies which at any time during any taxable year beginning after December 31, 1957, and ending before March 13, 1969, were members of the same affiliated group as such company, and

(C) such company (and each company referred to in subparagraph (B)) files a separate return for the first taxable year beginning after December 31, 1957, for which such company filed a consolidated return and for each taxable year thereafter ending before the date of the enactment of this Act, then notwithstanding any law or rule of law the requirement of filing a consolidated return shall be replaced by a requirement of separate returns for each company referred to in paragraph (2)(C) for each taxable year to which paragraph (2)(C) applies with respect to such company. Paragraph (2)(C) shall not apply with respect to any company for any taxable year the allowance of a credit for which is barred on the date of the enactment of this Act by res judicata or through the operation of section 7121 or section 7122 of the Internal Revenue Code of 1954.

(b) If the making or allowance of any refund or credit, or the assessment of any deficiency, of income tax for any taxable year to which subsection (a)(2)(C) applies is prevented before the expiration of 2 years after the date of the enactment of this Act by any law or rule of law (other than sections 7121 and 7122 of such Code and other than res judicata), such refund or credit may nevertheless be made or allowed, and such deficiency may nevertheless be assessed, at any time before the expiration of such 2-year period, but only to the extent that the overpayment or deficiency is attributable to an election made under this section. No interest shall be allowed on any credit or refund described in the preceding sentence, and no interest shall be assessed with respect to any deficiency described in the preceding sentence, for any period before the day which is one year after the date of the enactment of this Act.

I. SUMMARY

H.R. 19881 resolves the principal ambiguities which have arisen under the Life Insurance Company Income Tax Act of 1959 regarding the manner in which the provisions governing the taxation of life insurance companies are to be correlated with the provisions of the tax law governing the treatment of affiliated companies which file consolidated income tax returns. In general, the bill provides that life insurance companies which file consolidated tax returns are to compute the amount of their investment yield which is taken into account in determining their taxable income as if they were filing separate returns. In addition, it is provided that life insurance companies which previously filed consolidated returns under the 1959 act may elect to refile on a completely separate basis for those prior years.

This bill is reported unanimously by your committee and its enactment is not opposed by the Treasury Department.

II. REASONS FOR BILL

In the Life Insurance Company Income Tax Act of 1959, Congress extensively revised the income tax treatment of life insurance companies. This revision, however, did not include rules dealing with the taxation of a group of affiliated life insurance companies which elected to file a consolidated income tax return. The Internal Revenue Code as well as the Treasury regulations under both the life insurance company provisions and the consolidated return provisions have remained silent on the manner in which these two complex areas of the tax law relate to each other and are to be applied.

In the past, faced with this ambiguous situation, life insurance companies which elected to file a consolidated tax return eliminated intercorporate dividends from the various life insurance company tax computations. The elimination of intercorporate dividends is what is provided for generally in the case of consolidated returns and was provided for in the Treasury Department consolidated return regulations as a general rule. A recent court case (*Jefferson Standard Life Insurance Company* v. *United States*, 408 F. 2d 842 (CA. 4, 1969)), however, held that this method of computing an insurance company's taxable income was incorrect. The court held that intercorporate dividends should not be eliminated in computing the amount of each life insurance company's investment yield. The basis for the court's position was that the elimination of intercorporate dividends allowed a life insurance company to deduct a portion of those dividends twice. First, by eliminating the dividends from the life insurance company computations, the companies had, in effect, deducted the entire amount of the dividends. Second, a portion of the dividends, in effect, was again deducted as a part of the deduction allowed life innsurance companies for additions to their policyholder reserves.

It would appear to your committee that the principle enunciated by the court (namely, that life insurance companies filing consolidated tax returns should compute the amount of their investment yield which is taxable to them as if they were filing separate returns) is appropriate in view of the method provided in the tax law for taxing life insurance companies.

Your committee is concerned, however, with the effect this principle could have in the case of prior years where there was a lack of any official guidance as to the manner in which these provisions of the tax law were to be coordinated. The principle of the court deprived life insurance companies of the advantages they anticipated receiving from filing consolidated returns (primarily the elimination of intercorporate dividends) while not returning to them various benefits each company in the group would have had if completely separate returns had been filed (principally not having to pay the 2-percent penalty tax imposed prior to 1964 on companies which filed consolidated tax returns).

In view of these considerations, your committee's bill adopts the principle that life insurance companies filing consolidated tax returns are to compute their share of their investment yield as if they were filing separate tax returns. This rule is made applicable as of the effective date of the Life Insurance Company Income Tax Act of 1959. In addition, the bill deals with the problem of those insurance companies who, faced with a complex and unclear law, chose to file consolidated tax returns on the basis of the method of computation which it has subsequently been decided was incorrect. In these cases the bill provides that these companies may file separate tax returns for all prior years to which the Life Insurance Company Income Tax Act of 1959 was applicable beginning with the first year for which a consolidated return was filed. If this is done, the companies are to be allowed any credit or refund of tax, or reduction in a deficiency of tax, which may result solely from filing their returns on a separate, rather than a consolidated, basis. It is important to note that for this treatment to be available, however, the companies must file separate returns for all prior consolidated return years to which the 1959 act is applicable (other than years for which there has been a court decision or a closing agreement). In other words, the previous consolidation must be completely undone for this rule to apply.

III. EXPLANATION OF BILL

The bill provides that a life insurance company which files (or is required to file) a consolidated tax return for a year is to compute its share of its investment yield (i.e., the amount of its investment yield remaining after deduction of the policyholders' share of the investment yield) as if it were filing a separate tax return. This rule is to apply to the computation of the life insurance company's share of the investment yield under both phase I and phase II of the life insurance company tax provisions. Any determinations and computations which must be made in determining investment yield are to be made on a separate basis. Thus, each life insurance company included in the consolidated return is to separately determine its gross investment income, its deductions in arriving at its investment yield, its current, average, and adjusted earnings rates (including determinations based on the amount of its assets), and its policy and other contract liability requirements independently of the other companies included in the consolidated return. The same is true of the computation of the company's share of investment yield for purposes of the phase II life insurance company tax. The bill however, does not affect the manner in which other determinations which are necessary to arrive at the life insurance company's taxable investment income and gain from operations are to be made (i.e., determinations other than those which must be made in arriving at the insurance company's share of the investment yield).

This provision is to apply to all taxable years to which the Life Insurance Company Income Tax Act of 1959 is applicable (i.e., years beginning after December 31, 1957).

In addition, a rule is provided which allows those companies which filed consolidated income tax returns under the 1959 act for years ending prior to the enactment of the bill to file completely separate returns for those years up to 1 year after the enactment of the bill. This refiling on a separate basis is to be allowed for a taxable year notwithstanding any law or rule of law which would otherwise prevent it, unless there has been a court decision with respect to that year or the taxpayer has entered into a closing agreement with respect to that year.

The election provided by the bill may be made only if certain requirements are satisfied. First, the previous election to file consolidated returns must have been first made for a taxable year ending before March 13, 1969.[1] Second, a life insurance company which wishes to file a new separate return for a previous consolidated return year must elect (in the manner prescribed by the Secretary of the Treasury) this treatment and must file consents to the application of the election by all other companies which were members of the same affiliated group as the electing company for any taxable year beginning after 1957 and ending before March 13, 1969. Finally, the electing and consenting life insurance companies must file a separate return for the first taxable year under the 1959 act for which a consolidated return was filed and for each subsequent taxable year ending prior to the enactment of the bill (whether a separate or a consolidated return was previously filed for any of those subsequent years). A separate return is not to be filed, however, for any taxable year if the allowance of a credit for that year is barred by a court decision (res judicata) or a closing agreement. The election by a life insurance company to file its returns on a separate basis, the filing of the consents to that election of

[1] This is the date on which the *Jefferson Standard Life Insurance Company* case decision was rendered and, thus, is the date on which the taxpayers were first aware of judicial acceptance of the principle embodied in the first section of this bill.

the other affiliated companies, and the filing of the separate returns must be made within 1 year after the date of enactment of the bill.

Since it is intended that life insurance companies which previously filed consolidated returns under the 1959 act and which make the election to file separate returns completely undo the previous consolidation, the bill provides that if the statute of limitations on the assessment of a deficiency, or the allowance of a credit or refund, of income tax for any taxable year for which a refiling is required either ran or would run before the expiration of 2 years from the enactment of the bill, then a deficiency may be assessed, or a credit or refund allowed, for that year until the end of that 2 year period (whether a separate or a consolidated return was previously filed for that year). This waiving of the statute of limitations is only applicable, however, to the extent the deficiency or overpayment is attributable to the election to file separate, rather than consolidated, returns. For example, assume a life insurance company previously filed a consolidated return for a taxable year with respect to which the statute of limitations has run and eliminated intercorporate dividends from the computations of its taxable income (contrary to the rule provided by the bill) and paid the 2-percent penalty tax. If it makes the election provided under the bill and files a separate return, the election in general will extend the statute of limitations in two respects. First, there may be an assessment of the additional tax which arises from including the intercorporate dividends in the computation of the life insurance company's investment yield. Second, the life insurance company will be allowed to credit against that additional liability the amount of the 2-percent penalty tax it previously paid.

It is further provided that no interest may be assessed with respect to a deficiency of this nature and that no interest is to be allowed on any credit or refund of this nature for any period prior to 1 year after the enactment of the bill. Of course, if the statute of limitations for a prior taxable year with respect to which there is an outstanding deficiency has not run and the refiling of the company's tax return for that year on a separate, as opposed to a consolidated, basis results in a decrease in the amount of the deficiency, the company will not be assessed interest on the amount of the reduction in the deficiency (i.e. the amount for which it is no longer liable), but will be required to pay interest as computed under the normal rules with respect to the amount of the reduced deficiency. In addition, your committee intends that no additions to tax based on negligence or intentional disregard of rules and regulations should be imposed with respect to an underpayment which arises as a result of a life insurance company's failure to previously compute its income tax liability on the basis prescribed by the *Jefferson Standard Life Insurance Company* case and the first section of this bill.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 818 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 818. ACCOUNTING PROVISIONS.

(a) METHOD OF ACCOUNTING.—All computations entering into the determination of the taxes imposed by this part shall be made—

(1) under an accrual method of accounting, or

(2) to the extent permitted under regulations prescribed by the Secretary or his delegate, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).

Except as provided in the preceding sentence, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

(b) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—

(1) IN GENERAL.—The appropriate items of income, deductions, and adjustments under this part shall be adjusted to reflect the appropriate amortization of premium and the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

(2) SPECIAL RULES.—

(A) AMORTIZATION OF BOND PREMIUM.—In the case of any bond (as defined in section 171(d)) acquired after December 31, 1957, the amount of bond premium, and the amortizable bond premium for the taxable year, shall be determined under section 171(b) as if the election set forth in section 171(c) had been made.

(B) CONVERTIBLE EVIDENCES OF INDEBTEDNESS.—In no case shall the amount of premium on a convertible evidence of indebtedness include any amount attributable to the conversion features of the evidence of indebtedness.

(3) EXCEPTION.—For taxable years beginning after December 31, 1962, no accrual of discount shall be required under paragraph (1) on any bond (as defined in section 171(d)), except in the case of discount which is—

(A) interest to which section 103 applies, or

(B) original issue discount (as defined in section 1232(b)).

For purposes of section 805(b)(3)(A), the current earnings rate for any taxable year beginning before January 1, 1963, shall be determined as if the preceding sentence applied to such taxable year.

(c) LIFE INSURANCE RESERVES COMPUTED ON PRELIMINARY TERM BASIS.—For purposes of this part (other than section 801), at the election of the taxpayer the amount taken into account as life insurance reserves with respect to contracts for which such reserves are computed on a preliminary term basis may be determined on either of the following bases:

(1) EXACT REVALUATION.—As if the reserves for all such contracts had been computed on a net level premium basis (using the same mortality assumptions and interest rates for both the preliminary term basis and the net level premium basis).

(2) APPROXIMATE REVALUATION.—The amount computed without regard to this subsection—

(A) increased by $21 per $1,000 of insurance in force (other than term insurance) under such contracts, less 2.1 percent of reserves under such contracts, and

(B) increased by $5 per $1,000 of term insurance in force under such contracts which at the time of issuance cover a period of more than 15 years, less 0.5 percent of reserves under such contracts.

If the taxpayer makes an election under either paragraph (1) or (2) for any taxable year, the basis adopted shall be adhered to in making the computations under this part (other than section 801) for the taxable year and all subsequent taxable years unless a change in the basis of computing such reserves is approved by the Secretary or his delegate, except that if, pursuant to an election made for a taxable year beginning in 1958, the basis adopted is the basis provided in paragraph (2), the taxpayer may adopt the basis provided by paragraph (1) for its first taxable year beginning after 1958.

(d) SHORT TAXABLE YEARS.—If any return of a corporation made under this part is for a period of less than the entire calendar year (referred to in this subsection as "short period"), then section 443 shall not apply in respect to such period, but—

(1) the taxable investment income and the gain or loss from operations shall be determined, under regulations prescribed by the Secretary or his delegate, on an annual basis by a ratable daily projection of the appropriate figures for the short period.

(2) that portion of the life insurance company taxable income described in paragraphs (1) and (2) of section 802(b) shall be determined on an annual basis by treating the amounts ascertained under paragraph (1) as the taxable investment income and the gain or loss from operations for the taxable year, and

(3) that portion of the life insurance company taxable income described in paragraphs (1) and (2) of section 802(b) for the short period shall be the amount which bears the same ratio to the amount ascertained under paragraph (2) as the number of days in the short period bears to the number of days in the entire calendar year.

(e) TRANSITIONAL RULE FOR CHANGES IN METHOD OF ACCOUNTING.—

(1) IN GENERAL.—If the method of accounting required to be used in computing the taxpayer's taxes under this part for the taxable year 1958 is different from the method used in computing its taxes under this part for 1957, then there shall be ascertained the net amount of those adjustments which are determined (as of the close of 1957) to be necessary solely by reason of the change to the method required by subsection (a) in order to prevent amounts from being duplicated or omitted. The amount of the taxpayer's tax for 1957 shall be recomputed (under the law applicable to 1957, modified as provided in paragraph (4)) taking into account an amount equal to 1/10 of the net

amount of the adjustments determined under the preceding sentence. The amount of increase or decrease (as the case may be) referred to in paragraph (2) or (3) shall be the amount of the increase or decrease ascertained under the preceding sentence, multiplied by 10.

(2) TREATMENT OF DECREASE.—For purposes of subtitle F, if the recomputation under paragraph (1) results in a decrease, the amount thereof shall be a decrease in the tax imposed for 1957; except that for purposes of computing the period of limitation on the making of refunds or the allowance of credits with respect to such overpayment, the amount of such decrease shall be treated as an overpayment of tax for 1959. No interest shall be paid, for any period before March 16, 1960, on any overpayment of the tax imposed for 1957 which is attributable to such decrease.

(3) TREATMENT OF INCREASE.—

(A) IN GENERAL.—For purposes of subtitle F (other than sections 6016 and 6655), if the recomputation under paragraph (1) results in an increase, the amount thereof shall be treated as a tax imposed by this subsection for 1959. Such tax shall be payable in 10 equal annual installments, beginning with March 15, 1960.

(B) SPECIAL RULES.—For purposes of subparagraph (A)—

(i) No interest shall be paid on any installment described in subparagraph (A) for any period before the time prescribed in such subparagraph for the payment of such installment.

(ii) Section 6152(c) (relating to proration of deficiencies to installments) shall apply.

(iii) In applying section 6502(a)(1) (relating to collection after assessment), the assessment of any installment described in subparagraph (A) shall be treated as made at the time prescribed by such subparagraph for the payment of such installment.

(iv) Except as provided in section 381(c)(22), if for any taxable year the taxpayer is not a life insurance company, the time for payment of any remaining installments described in subparagraph (A) shall be the date (determined without regard to any extension of time) for filing the return for such taxable year.

(4) MODIFICATIONS OF 1957 TAX COMPUTATION.—In recomputing the taxpayer's tax for 1957 for purposes of paragraph (1)—

(A) section 804(b) (as in effect for 1957) shall not apply with respect to any amount required to be taken into account by such paragraph, and

(B) the amount of the deduction allowed by section 805 (as in effect for 1957) shall not be reduced by reason of any amount required to be taken into account by such paragraph.

(f) DENIAL OF DOUBLE DEDUCTIONS.—Nothing in this part shall permit the same item to be deducted more than once under subpart B and once under subpart C.

(g) Computation on Consolidated Returns of Policyholders' Share of Investment Yield.—For purposes of this part, in the case of a life insurance company filing or required to file a consolidated return under section 1501 for a taxable year, the computations of the policyholders' share of investment yield under subparts B and C (including all determinations and computations incident thereto) shall be made as if such company were not filing a consolidated return.

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